

1 HONORABLE RICARDO S. MARTINEZ  
2  
3  
4  
5  
6  
7  
8

9  
IN THE UNITED STATES DISTRICT COURT  
FOR THE WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

10 UNITED STATES OF AMERICA,

NO. 2:15-cv-00102 RSM

11 Petitioner,

DECLARATION OF MICHAEL BERNARD  
IN SUPPORT OF MICROSOFT'S BRIEF  
REGARDING COMMON DEFENSES TO  
ENFORCEMENT OF SUMMONSES

12 v.  
13 MICROSOFT CORPORATION, et al.,

14 Respondents.  
NOTED FOR: November 6, 2015

15 UNITED STATES OF AMERICA,

NO. 2:15-cv-00103 RSM

16 Petitioner,

17 v.  
18

19 CRAIG J. MUNDIE, et al.,

20 Respondents.

21  
22 I, Michael J. Bernard, pursuant to 28 U.S.C. § 1746, declare as follows:

23 1. I am U.S. Tax Counsel for Microsoft Corporation ("Microsoft") and have  
24 served in that capacity since the early 1990s. I hold a Bachelor of Science in Business  
25 Administration and a Juris Doctor degree from Creighton University. I am an attorney.

DECLARATION OF MICHAEL BERNARD - 1  
(Case Nos. 2:15-cv-00102 RSM & 2:15-cv-00103 RSM)

LAW OFFICES  
CALFO HARRIGAN LEYH & EAKES L.L.P.  
999 THIRD AVENUE, SUITE 4400  
SEATTLE, WASHINGTON 98104  
TEL (206) 623-1700 FAX (206) 623-8717

1       2. I have been directly involved in the Internal Revenue Service (“IRS”) audits of  
 2 Microsoft’s tax returns for the years ended June 30, 1990-1991, 1992-1994, 1995-1996, 1997-  
 3 1999, 2000-2003, and 2004-2006. The 2004-2006 years are at issue in the summons  
 4 enforcement actions pending before the Court.

5       3. I previously submitted two declarations in connection with Microsoft’s Motion  
 6 for an Evidentiary Hearing in this consolidated case. Attached and marked as Exhibit 1 is a  
 7 true and complete copy of my March 18, 2015, declaration and the accompanying exhibits. I  
 8 am not including here exhibits B-F because those documents are included as attachments to  
 9 this declaration, *see ¶¶ 18-22, Exs. 3-7.* Attached and marked as Exhibit 2 is a true and  
 10 complete copy of my April 23, 2015, declaration and the accompanying exhibits. I affirm that  
 11 the representations made in my prior declarations were, and remain, true and correct.

12      4. The IRS’s audit of Microsoft’s 2004-2006 taxable years began in January 2007  
 13 and has focused on two cost sharing arrangements for the Americas and APAC regions entered  
 14 into with subsidiaries during the years under audit.

15      5. Between January 2007 and May 2011, the IRS issued 77 Information Document  
 16 Requests (“IDRs”) relating to the Americas and APAC cost sharing arrangements and transfer  
 17 pricing. In response, Microsoft voluntarily produced approximately 8,900 pages of documents  
 18 and arranged 18 consensual interviews.

19      6. On May 3, 2011, the IRS examination team issued to Microsoft a thirty-day  
 20 letter, which transmitted (i) a Revenue Agent’s Report (95 pages of which described the factual  
 21 and legal support for the proposed Americas and APAC adjustments) and (ii) four expert  
 22 reports (almost 400 pages of factual, economic, and legal analyses). Microsoft responded by  
 23 filing a protest brief that challenged the IRS’s position.

24      7. In October 2011, we learned that a new group within LB&I, Transfer Pricing  
 25 Operations (“TPO”), intended to conduct additional audit field work for the purpose of the

1 TPO presenting to the IRS Appeals Division a secondary or alternative buy-in valuation to the  
 2 primary buy-in valuation made in the thirty-day letter. The IRS subsequently issued a letter  
 3 rescinding the May 3, 2011 thirty-day letter.

4       8. While continuing to rely on the primary valuation (*see Paragraph 6 above*), the  
 5 IRS also engaged additional experts, including a new economist, industry specialists and a  
 6 software engineer, and requested additional documents to develop an alternative valuation.  
 7 During the extended audit, the IRS provided Microsoft with several audit Timelines. On or  
 8 about May 30, 2013, the IRS submitted its last Timeline, which was never subsequently  
 9 updated. The May 30, 2013, Timeline called for the TPO concluding the audit in late-2013 and  
 10 issuing a new thirty-day letter by April 1, 2014. A true and complete copy of the May 30,  
 11 2013, Timeline is attached as Exhibit 4 to the Declaration of Daniel Rosen in Support of  
 12 Microsoft's Brief Regarding Common Defenses to Enforcement of Summons.

13       9. Between November 17, 2011, and December 31, 2013, the TPO issued an  
 14 additional 63 IDRs relating to the Americas cost sharing arrangement and transfer pricing. In  
 15 response, Microsoft voluntarily produced approximately 1.2 million pages of documents and  
 16 arranged 13 employee interviews.

17       10. In December 2013, the IRS TPO advised Microsoft that—consistent with its  
 18 Timeline—the audit work was substantially completed, that it had quantified the alternative  
 19 valuations, and that it would be producing supporting reports.

20       11. Microsoft, the IRS, and their counsel met in Washington, D.C. on January 14,  
 21 2014. At this meeting, the IRS made a formal presentation of its alternative valuation  
 22 methodology.

23       12. On February 17, 2014, Bill Sample, Microsoft Global Vice President of Tax,  
 24 and I spoke with Samuel Maruca, IRS TPO Director, and Eli Hoory, Special Projects Deputy,  
 25 IRS TPO. Mr. Sample informed the IRS that Microsoft would not pursue settlement and

1 requested a thirty-day letter terminating the audit. On March 27, 2014, I reiterated to Mr.  
 2 Hoory Microsoft's position, again indicating that Microsoft would not negotiate a settlement  
 3 and requesting a thirty-day letter. Microsoft made clear in February and March 2014 that the  
 4 significant differences in Microsoft's and the IRS's positions—which would not be materially  
 5 impacted by resolution of the basic mechanical issues—made settlement impossible.

6       13. During subsequent status calls over the next several months, Mr. Hoory  
 7 continued to assure me that the IRS would complete the extended field audit by December 31,  
 8 2014.

9       14. On May 12, 2014, Mr. Hoory asked me to arrange several consensual  
 10 interviews of Microsoft financial personnel for purposes of the IRS TPO wrapping up the field  
 11 audit.

12       15. Unbeknownst to Microsoft at the time, the IRS engaged the civil litigation law  
 13 firm of Quinn Emanuel Urquhart & Sullivan LLP (“Quinn Emanuel”) in this case pursuant to a  
 14 government contract executed on May 19, 2014.

15       16. In July 2014, the TPO issued 12 additional IDRs increasing the number of  
 16 requested interviews. By mid-August, we identified a pool of over 50 potential interviewees,  
 17 from which the TPO identified 29 former or current Microsoft employees for interviews during  
 18 September/October, 2014.

19       17. Before resigning as the IRS TPO Director in early August 2014, Mr. Maruca  
 20 joined Mr. Hoory in a status call with Mr. Sample and me. Mr. Maruca advised us that the IRS  
 21 would conclude the audit either by issuing a thirty-day letter or designating the case for  
 22 litigation following the interviews scheduled for September/October, 2014.

23       18. Attached and marked as Exhibit 3 is a true and complete copy of a letter from  
 24 Mr. Hoory to me dated August 28, 2014. This letter itemizes the specific individuals whom the  
 25 TPO intended to interview. The letter also states:

DECLARATION OF MICHAEL BERNARD - 4  
 (Case Nos. 2:15-cv-00102 RSM & 2:15-cv-00103 RSM)

LAW OFFICES  
 CALFO HARRIGAN LEYH & EAKES LLP  
 999 THIRD AVENUE, SUITE 4400  
 SEATTLE, WASHINGTON 98104  
 TEL (206) 623-1700 FAX (206) 623-8717

1           To follow up on our discussion on August 28th, in addition to  
 2           representatives from the LB&I examination team and IRS counsel, we  
 3           likely will have one or more contractors attend, participate and/or listen  
 4           in to the interviews. In addition to our economist and industry experts,  
 5           this may include **outside counsel** from Quinn Emanuel retained to  
 6           assist LB&I in its evaluation and examination of this matter.

7           Exhibit 3 at 3 (emphasis added). This letter was the TPO's first disclosure to Microsoft that it  
 8           had engaged outside counsel. The letter also advised that the TPO's experts and outside  
 9           counsel (collectively, the "Contractors") would "participate" in the interviews.

10          19. Attached and marked at Exhibit 4 is a true and complete copy of my letter to  
 11         Mr. Hoory, dated September 3, 2014. At page 2, I asked "whether Quinn Emanuel has been  
 12         engaged in an expert capacity or to represent the IRS as trial counsel if this matter proceeds to  
 13         litigation." I also requested a "complete, unredacted copy of the IRS engagement letter with  
 14         Quinn Emanuel."

15          20. Attached and marked as Exhibit 5 is a true and complete copy of Mr. Hoory's  
 16         letter to me dated September 9, 2014. At page 3, Mr. Hoory stated that "As communicated in  
 17         prior discussions, the IRS has not yet made a determination on how to process the unagreed  
 18         issues in the FY04-06 cycle, all options remain open, and you can anticipate a final decision  
 19         after the interviews scheduled for September and October. Consistent with the procedural  
 20         status of the audit, QE has not been retained for litigation support. Rather, QE's engagement is  
 21         currently limited to examination support." At page 4, Mr. Hoory asserted that "[t]he IRS does  
 22         not have an engagement letter with QE."

23          21. Microsoft subsequently reviewed the Office of Management & Budget database  
 24         disclosing government contracts. That database disclosed Contract No. TIRNE-14-C-00013 as  
 25         a contract between the IRS and Quinn Emanuel for "Professional Expert Witness" services.

1 This contract was executed on May 19, 2014, and had a stated “Obligation Amount” of  
 2 \$2,185,500. Attached and marked as Exhibit 6 is a true and complete copy of my letter to Mr.  
 3 Hoory, dated September 10, 2014, requesting a copy of Contract No. TIRNE-14-C-00013.

4       22. Attached and marked as Exhibit 7 is a true and complete copy of Mr. Hoory’s  
 5 letter to me, dated September 10, 2014, and Section C (the Performance Work Statement) from  
 6 Contract No. TIRNE-14-C-00013. But for Section C, the IRS withheld the contract. Section C  
 7 refers to Quinn Emanuel’s work as “Phase I” or “this phase” and does not mention any other  
 8 phases. Mr. Hoory represented at page 1 of this letter that “Section C contains the full and  
 9 unredacted work statement/scope of work for all phases of the contract (the contract has one  
 10 phase only).” This letter asked us to agree that the Contractors could “fully participate in the  
 11 interviews, including, but not limited to, asking questions,” citing the temporary regulation  
 12 under 26 U.S.C. § 7602.

13       23. Microsoft would not agree that the Contractors could “participate fully” in the  
 14 interviews, but ultimately agreed to allow the interviews to go forward under certain limiting  
 15 conditions. I consented to the September/October interviews based on Mr. Maruca’s and Mr.  
 16 Hoory’s representations that the IRS would conclude its audit after the interviews by the end of  
 17 2014 and my understanding—based on Mr. Hoory’s representations and Section C of the IRS’s  
 18 contract with Quinn Emanuel—that the IRS’s contract with Quinn Emanuel did not envision  
 19 Quinn Emanuel serving as litigation counsel.

20       24. Instead of closing the audit after the September/October interviews, the IRS  
 21 issued a designated summons and multiple related summonses to Microsoft and several current  
 22 and former employees. In my 25 years of experience in corporate tax audits, I am not aware of  
 23 a single instance in which the IRS had issued a designated summons. Most of the testimonial  
 24 summonses, which are the subject of this case, were for individuals from whom the IRS, in the  
 25 prior seven years of the audit, had not previously sought testimony. The summonses also seek

1 testimony from more senior Microsoft personnel than the IRS had ever sought before in the  
2 audit. In addition, unlike any prior interviews during the audit, the IRS seeks to videotape the  
3 summons interviews. Most of the requests in the documents summonses sought documents that  
4 the IRS had not previously requested from Microsoft.

5       25. Had I known that the IRS would not close the audit after the September/October  
6 interviews and had I known the IRS's contract with Quinn Emanuel contained provisions that  
7 1) bind Quinn Emanuel to participate in four non-severable phases; 2) extend the contract  
8 period of performance through 2016, depending on "the litigation schedule of the government"  
9 and "the Court's schedule," and 3) require Quinn Emanuel to preserve its ability to serve as  
10 special government employees, I would not have consented to the September/October  
11 interviews.

12                         \* \* \*

13       I declare under penalty of perjury that the foregoing is true and correct.

14       Executed on this 17th day of September, 2015.

15                         MICHAEL J. BERNARD

16       By 

17                         Microsoft Corporation  
18                          U.S. Tax Counsel

19  
20  
21  
22  
23  
24  
25

DECLARATION OF MICHAEL BERNARD - 7  
(Case Nos. 2:15-cv-00102 RSM & 2:15-cv-00103 RSM)

LAW OFFICES  
CALFO HARRIGAN LEYH & EAKES LLP  
999 THIRD AVENUE, SUITE 4400  
SEATTLE, WASHINGTON 98104  
TEL (206) 623-1700 FAX (206) 623-8717

## **CERTIFICATE OF SERVICE**

I hereby certify that on September 18, 2015, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the following:

**Hugh F. Bangasser**  
[Hugh.bangasser@klgates.com](mailto:Hugh.bangasser@klgates.com)

**Mirelle R. Oldak**  
[Mireille.oldak@bakermckenzie.com](mailto:Mireille.oldak@bakermckenzie.com)

**Philip S. Beck**  
Philip.beck@bartlit-beck.com

**Brian S. Prestes**  
[brian.prestes@bartlit-beck.com](mailto:brian.prestes@bartlit-beck.com)

**Sean W. Gallagher**  
Sean.gallagher@bartlit-beck.com

**Daniel A. Rosen**  
[Daniela.rosen@bakermckenzie.com](mailto:Daniela.rosen@bakermckenzie.com)

George E. Greer  
[ggreer@orrick.com](mailto:ggreer@orrick.com)

**Stephen M. Rummage**  
steverummage@dwt.com

**Jeremy N. Hendon**  
Jeremy.hendon@usdoj.gov

**Amy Matchison**

**Noreene C. Stehlik**  
noreene.c.stehlik@usdoj.gov

**Amy Matchison**  
Amy.t.matchison@usdoj.gov

**Robert B. Tannenbaum**  
Robert.tannenbaum@bartlit-beck.com

**Robert B. Mitchell**  
Robert.mitchell@klgates.com

**Phillip J. Taylor**  
[phillip.taylor@bakermckenzie.com](mailto:phillip.taylor@bakermckenzie.com)

## James M. O'Brien

## James E. Weaver

James M. O'Brien  
James.m.o'brien@bakermckenzie.com

**James E. Weaver**  
james.e.weaver@usdoj.gov

CALFO HARRIGAN LEYH & EAKES LLP

By: s/ Patricia A. Eakes

Patricia A. Eakes, WSBA #18888  
999 Third Avenue, Suite 4400  
Seattle, WA 98104  
Tel: (206) 623-1700  
Fax: (206) 623-8717  
Email: [pattye@calfoharrigan.com](mailto:pattye@calfoharrigan.com)

*Attorneys for Respondent / Intervenor  
Microsoft Corporation*

**DECLARATION OF MICHAEL BERNARD - 8**  
**(Case Nos. 2:15-cv-00102 RSM & 2:15-cv-00103 RSM)**

LAW OFFICES  
**CALFO HARRIGAN LEYH & EAKES LLP**  
999 THIRD AVENUE, SUITE 4400  
SEATTLE, WASHINGTON 98104  
TEL (206) 623-1700 FAX (206) 623-8717